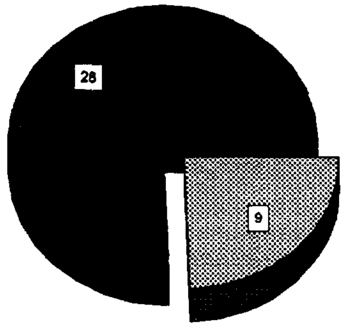
RESULTS OF DIVESTITURES IN 37 CASES



■ buyer was in and operating
▒ divestiture was not viable

sought to confirm the effect of the buyer's entry and the nature of the effect by interviewing the buyer and, where possible, the respondent. Where the buyer was able to begin operating in the relevant market relatively quickly and had the ability to compete effectively in that market, the operations were considered viable and the purposes of the divestiture were deemed to have been achieved.

Of the 37 divestitures that were studied, 28 appear to have resulted in viable operations in the relevant market. In each case, the approved buyer acquired the assets, began operations, and was operating in the relevant market within a reasonable period. In some of these cases, the buyer reported that it introduced new products, it is pricing below the respondent, or it is taking share from the respondent. In the remaining nine divestitures, the buyers are not operating viably in the relevant market. (In one of those nine, the buyer was operating viably, but not in the relevant market of concern to the Commission; in another, the buyer was operating viably but not independently of the respondent.). Approximately 75 percent of the divestitures were successful. This is comparable to the success rate reported for privately negotiated mergers and acquisitions.[19]

3. Divestitures of on-going businesses succeeded at a higher rate than divestitures of selected assets

The Study indicates that divestiture of an on-going business is more likely to result in a viable operation than is divestiture of assets selected to facilitate entry. The general notion that the sale of an on-going business is more likely to be successful in establishing a competitor than the sale of less than an entire business seems intuitively obvious and is consistent with the reasons for Congressional concern about a lack of organic integrity of divested businesses. It was important in the Study to attempt to examine how much of a disadvantage was posed by partial divestitures, because the Commission has approved in recent years an increasing number of partial divestitures that are designed to restore competition by facilitating entry rather than by maintaining a competitive entity.

The definitions of the assets to be divested in the orders studied fall along a continuum: on one end of the continuum is a package defined to include all the assets necessary to effect an

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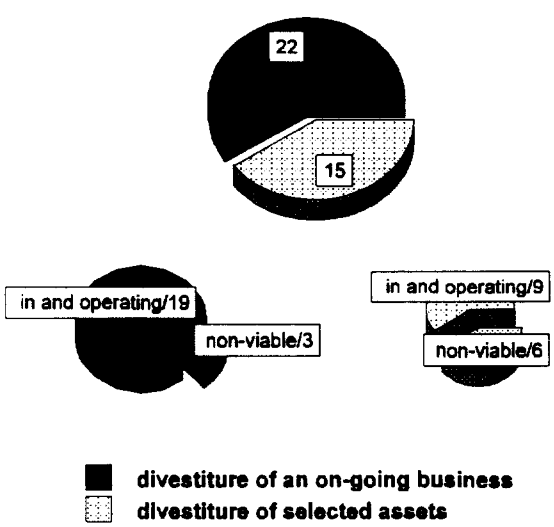
[19] Ravenscraft and Scherer, for example, suggest that "roughly a third" of their sample of private transactions were viewed as failures by the acquiring firms. D. Ravenscraft and F.M. Scherer, MERGERS, SELL-OFFS, AND ECONOMIC EFFICIENCY 192-93 (1987). Michael Porter's contemporaneous review of the acquisitions puts the failure rate much higher. He found "more than half" the acquisitions he studied were sold off because they did not meet the acquiring firm's expectations. Porter, "From Competitive Advantage to Corporate Strategy," HARV. BUS. REV. 45 (May-June 1987).

immediate and potentially long-term transfer of the market share attributable to those assets. On the other end of the continuum is a package defined by carving out only those assets identified as necessary to facilitate entry. In the first case, the assets include most typically an established customer base, a fully staffed facility of some sort (a manufacturing facility or a retail operation) or an otherwise self-contained business unit that may have product contract packed, a manufacturing and/or sales force, perhaps a research and development team, and other assets that are included in the business, including ancillary agreements and third-party contracts. This type of divestiture should result in the almost immediate transfer of market share from respondent to buyer. Most of the packages of assets labeled as "on-going businesses" had not, however, actually been operated as autonomous businesses before the divestiture; nevertheless, they were characterized this way because the market share attributed to the assets could be transferred immediately and potentially for the long-term. A buyer could buy and be operational the next day, selling to all of the same customers.

At the other end of the continuum, some divestiture packages contain a set of assets that are designed to facilitate entry (in the expectation that the competition lost by a merger will eventually be replaced by the buyer) rather than an on-going business. These assets are typically intellectual property, technology or know-how, brand names, research and development, and/or selected pieces of equipment. In these cases, there is no on-going business; thus, there will be no immediate transfer of market share. Instead, the Commission has required divestiture of those selected assets that a firm might need to overcome the existing impediments to entry. The buyer must bring with it whatever else is needed to complete the picture and enter the market. The buyer may be unable to produce the product itself immediately because it may have to modify its existing facility independently, qualify the product with customers, or obtain necessary governmental approvals. Because the buyer is not simply stepping into the shoes of an existing competitor operating an on-going business, entry may not be immediate and the effects not immediately known.

VIABILITY OF DIVESTITURES

On-Going Business/Selected Assets



Of the 37 divestitures that were studied, 22 were of assets that comprised on-going businesses. Of those 22, 19 were viable in the relevant market virtually immediately after the divestiture. Of the three that were not: one involved divestiture of a business that was not viable at the time of the divestiture; one involved divestiture of a business that was not operated independent of respondent after the divestiture; and one involved a business that was not really operating in the relevant market at the time of divestiture, and the buyer of the business did not subsequently enter that market. Of the 15 divestitures of selected assets, nine resulted in viable firms; five were so problematic that the results were not viable, and one was not operating independently of the respondent in the relevant market.

The Study thus suggests that divestiture of an on-going business is more likely to result in a viable operation than divestiture of a more narrowly defined package of assets and provides support for the common sense conclusion that the Commission should prefer the divestiture of an on-going business. The Study nevertheless indicates that divestitures of selected assets can succeed. Where the Commission determines that the divestiture of an on-going business is undesirable because it would destroy the efficiencies of a merger, the case studies indicate ways that the higher risks associated with a partial divestiture can be reduced. As is discussed in Section II.C. below, these risks can be reduced by affording greater protection to the buyer of the divested assets by including provisions requiring the use of auditor trustees, rights to hire employees, rights to technical assistance, and supply contracts.

4. Continuing relationships with respondents post divestiture may increase the vulnerability of buyers of divested assets but may be critical to the success of some buyers

The case studies indicate that relationships between the buyer of divested assets and the respondent, which continue beyond the transfer of the divested assets, may increase the vulnerability of the buyers of the divested assets, particularly in those cases in which the divested assets comprise less than an on-going business. However, the continuing relationships between the buyer and respondent may often have been critical to the success of the buyer of the divested assets. These conflicting results emphasize the complexity of the issues surrounding these continuing relationships.

Nineteen of the 37 buyers that were interviewed maintained some sort of continuing relationship with the respondent after the divestiture was consummated.[20] Of the nineteen, in six cases the continuing relationship was so detrimental that it prevented the buyer from operating competitively in the market. In an additional seven cases, the continuing relationship was harmful to the buyer, but not so harmful as to prevent the buyer from operating in the market competitively. In the remaining six cases, continuing relationships such as supply contracts or technical assistance obligations were not only helpful to the buyer but were critical to the subsequent success of the buyer.

Based on the numbers alone, it appears that staff should be concerned about cases in which these relationships continue post-divestiture. But it is also clear from the interviews that in some cases continuing relationships are necessary to ensure the success of the buyer, particularly in those cases in which less than an on-going business is divested.[21] As described in

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[20] One additional buyer was entitled to technical assistance post-divestiture but chose not to use it, relying on its own know-how instead.

[21] Of course, those are the very cases in which these continuing relationships were most responsible for the inability of the buyer to compete viably in the market. In seven out of

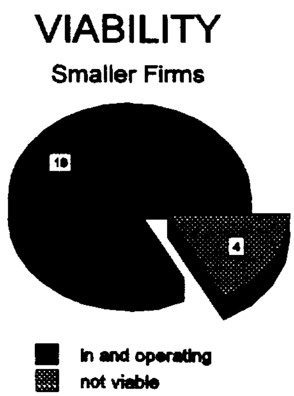
(continued...)

Section II.C. below, the information obtained from the case studies allows for some understanding of which types of relationships can be productive and what protections can be written into the Commission's orders or required in the divestiture contracts to maximize the usefulness of the relationships.

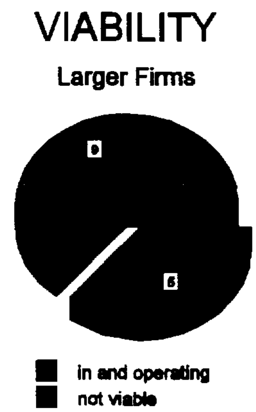
[21] (...continued)
the nine cases labeled "not viable," some sort of relationship between respondent and buyer survived post-divestiture and in some way contributed to the nonviability of the divested assets.

5. Smaller firms appear to succeed at least at the same rate as larger firms

The Study indicates two and perhaps three characteristics of buyers that increase the chances for success of the divested business: knowledge of and experience in the business; commitment to the business; and, for a combination of reasons, the size of the buyers.[22]



While a large majority of the divestitures to large and small firms were successful, the case studies indicate that smaller, more entrepreneurial firms have succeeded at least at the same rate as large, multi-divisional firms. Of 23 divestitures to smaller firms, three were found to be not viable.[23] Four of the 14 divestitures to larger firms were not viable.[24] The smaller firms' failure rate of 14 percent was less than the more than 30 percent failure rate of the larger firms. It, thus, seems important not to assume that smaller firms will be weaker competitors.



6. Summary

These general findings support useful rules-of-thumb for merger remedies. Divestitures can restore competition that would be lost as a result of a merger. Divestiture of an entire business is more likely to be successful than the divestiture of parts of a business. Buyers who must rely on respondents for continuing support to enter a business with the divested assets are more vulnerable than buyers who do not need that support. Small entrepreneurial firms have been at least as successful with divested assets as large corporations.

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[22] The factors that contribute to the success of any particular buyer – knowledge and experience, commitment, and size – are discussed in section II.C.

[23] An additional divestiture involved assets that the buyer was not operating independent of the respondent but which the buyer was operating profitably nonetheless. Thus, although the buyer was satisfied, the divestiture may not have fully restored competition to the market of concern to the Commission.

[24] An additional divestiture in this category involved divestiture of assets that were not in the relevant market at the time of the divestiture, and the buyer never entered the relevant market.

Although these general findings point toward types of divestitures that should be preferred, they do not provide specific guidance on how to formulate remedies in individual cases where more limited relief is pursued. Accordingly, the Study has examined the individual divestitures to assist in the staff's understanding of problems faced by the buyers of divested assets and how specific provisions of orders and divestiture contracts have helped or hurt the buyers.

C. The Study presents a new view of the dynamics of the divestiture process, identifying obstacles to effective divestitures as well as ways to overcome the obstacles

1. A new view of the dynamics of the divestiture process

Prior to the Study, staff had assumed that a rough balance of information and bargaining power existed between respondents and the buyers of divested assets. The Study indicates, instead, that buyers appear to be at a substantial disadvantage. For example, buyers who have not operated in the industry are at a severe disadvantage in defining what assets they need and determining whether they are receiving all the assistance to which they are entitled. Especially in orders that require the divestiture of less than an entire business, the buyers lack important information about the business that is being divested. This lack, this industry ignorance, is not the result of carelessness, of a failure to perform due diligence, or of poor judgment; it is an inherent characteristic of entering a new business. That disadvantage, and others that are discussed below, can be mitigated by some changes in the divestiture process.

Staff started the Divestiture Study with the common sense assumption that respondents do not seek out their strongest rivals to become buyers of the to-be-divested assets but instead tend to choose the most marginally acceptable buyer. The interviews with buyers of divested assets support that assumption. Some buyers believe that they were chosen because the respondents expected them to be weak competitors. It appears that some respondents hope, or even expect, these weak competitors will fail to successfully exploit the assets. Staff also assumed that respondents may take actions intended to make the divested assets less competitive, either as a result of indifference or as part of a planned strategy. The study provides support for that assumption as well.

Staff further assumed that respondents conduct would be balanced by the self-interest of those buyers who have the advantage of bidding on a compulsory divestiture that must be accomplished within a stated period of time at no minimum price. In other words, staff expected that a buyer's bargaining power would not be significantly less than that of the respondent in negotiating the divestiture contract. Furthermore, staff has relied on the fact that buyers were willing to enter into divestiture contracts as evidence that the divested assets were valuable and adequate to establish the buyer as a viable competitor to the respondent.

Contrary to these expectations, it appears that buyers generally perceived that they had much less bargaining power than respondents. Indeed, it appears that buyers tended to handicap themselves as a result of two factors. First, some seemed to be willing to trade away the competitive strengths and protection the order was intended to give them because they assumed the divested assets were a bargain and they were afraid some other buyer would be chosen by respondent if they haggled. Second, many buyers, including large, apparently sophisticated, multinational corporations, seemed to be unaware of major economic factors in the businesses they were buying. Accordingly, they sometimes agreed to pay too much for the assets that they were acquiring or did not insist upon the transfer of necessary additional assets.

The lessons learned from the Study about the dynamics of the divestiture process have led the staff to alter its role in the process. To a greater or lesser extent, it had assumed a balance of bargaining power and information existed between the respondents and the buyers of divested assets. That presumed balance provided the staff and the Commission with a justification for accepting respondent's proposal when they were accepted by buyers. If the buyers signed purchase agreements and did not complain about what they received, that was evidence that the orders were likely to achieve their intended results. To be sure, the proposed divestiture remedy, the buyer, and the divestiture contract were examined carefully, but the presumption was that the buyer was in a position to adequately defend its interests. The Study suggests that the staff must attempt to balance the bargaining power between the buyers and respondents in order to protect the remedies that the Commission orders.

2. Obstacles to effective divestitures

a. Respondents

Respondents generally did what was required of them by the orders and little more. The buyers, however, reported three kinds of activity that respondents engaged in that could lessen the competitiveness of divested assets in the hands of the buyers: (1) respondents urged the Commission to define too narrowly the package of assets to be divested; (2) respondents urged the Commission to divest the assets to weak buyers; and (3) respondents took actions that diminished the viability of the business acquired by the buyers.

(1) Respondents urge limited divestiture packages

The divestiture package in consent orders is initially defined in a negotiation between the Commission staff and the respondent. With the benefit of the hindsight offered by the Study, it appears that some of the divestiture packages were not adequate to fully achieve the remedial purpose of the Commission's orders.

- **Firm 5** [25] purchased the right to produce three products made by respondent and the equipment on which the products were made, as the order required. It objected, however, that the order should have included a fourth product, which would have given Firm 5 a full line. Firm 5 attempted to negotiate the purchase of the rights to the fourth line from respondent, but respondent refused because the order did not require it. Firm 5 contended

[25] To maintain the confidentiality of the participants in the Divestiture Study, none is identified by name. Instead, each buyer is referred to by a randomly assigned number.

that the order's failure to assure that the buyer would have access to a full line of products made it more difficult for the buyer to compete.

- **Firm 14** acquired from the respondent the technological specifications to produce a product related to Firm 14's product. The order also required respondent to supply critical raw material to Firm 14, but only on a limited basis. Firm 14 stated that it was fatally disadvantaged by the order's limitation on respondent's supply obligations. The restricted supply of indispensable materials prevented the buyer from securing a customer base that might have made the business viable.

- **Firm 22** acquired the assets that respondent was required to divest. The divestiture package, however, primarily involved assets that operated in a market unrelated to the complaint market. Firm 22 pursued the unrelated market to the exclusion of the market the Commission was concerned about.

(2) Respondents may propose weak buyers

Respondents are responsible for finding and proposing an acceptable buyer of the to-be-divested assets and completing the divestiture by the order's deadline. They are not required to choose the person likely to be the strongest buyer, and many buyers reported they had the impression they were chosen because respondent did not expect them to be a strong competitor.[26]

- **Firm 9** acquired the rights to manufacture a product from respondent, but was unsuccessful in its efforts to compete in the sales of that product. Firm 9 believed that it was chosen in part because it was a start-up company with no operational experience. Respondent and Firm 9 made a successful divestiture proposal on the grounds that the president of Firm 9 had significant expertise in the technical aspects of the complex production process and had the business backing of a successful venture capital firm. While the fact that Firm 9 failed does not necessarily mean that the Commission should not have approved the divestiture application, it appears that a firm with more business experience and more funds could have coped better with the problems that caused Firm 9 to fail.

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[26] Of course, the Commission is not required to accept whatever buyer respondent proposes. In fact, the Commission may disapprove a marginally acceptable buyer if a better buyer might be available. For example, where a proposed divestiture to an incumbent in the market would reduce concentration some but not enough to remedy the loss of competition, the Commission has denied the application for divestiture. In reviewing the Commission's decision in *Internorth, Inc.*, 106 F.T.C. 312 (1985) to approve a proposed divestiture of a pipeline interest to Teco instead of Valero, the pipeline partner, the district court in *West Texas Transmission L.P. v. Enron Corp. et al.*, 1989-1 Trade Cases (CCH) ¶68,424 at 60,334 (W.D. Texas 1988), *aff'd on other grounds* 907 F.2d 1554 (5th Cir. 1990), *cert. denied* 499 U.S. 906 (1991), stated that "the FTC was entitled to consider which of the competing applications -- Teco's or Valero's would better serve the remedial purposes of the Consent Order." That is, the Commission could approve the better applicant.

(3) Respondents may engage in strategic behavior to impede the success of the buyer

Buyers also reported that actions of respondents undermined the businesses that they acquired. Some buyers believe these included actions that were intended by respondents to undermine the buyers' efforts to establish their businesses.

- **Firm 9** acquired from respondent the rights to manufacture a particular product. Until it was able to manufacture the product itself, Firm 9 contracted with respondent to supply the product to Firm 9. Almost immediately after the divestiture, however, respondent's production line went down and respondent was unable to supply product to Firm 9 for a significant period of time. In retrospect, Firm 9 suspects that respondent's failure to deliver was intentional because respondents's production line had never previously been closed down for that length of time.

- **Firm 17** acquired the rights to produce a line of consumer goods from respondent. Firm 17 reported that, prior to the divestiture, respondent had access to confidential information about the product it was required to divest and that, after the divestiture, respondent used that information to undermine Firm 17's introduction of a new product by simultaneously introducing a similar product.

- **Firm 28**, which also acquired rights to produce a line of consumer goods, reported a similar experience to Firm 17. According to Firm 28, when Firm 28 introduced the newly acquired product in a regional market, the respondent timed its test marketing of a similar product so that it disrupted the introduction of Firm 28's product.

Many more buyers reported that they suffered from respondents' failures to fully provide required technical assistance.

- **Firm 5** acquired the rights to produce three lines of product from the respondent and the equipment on which the divested lines of products were made. Respondent was also required to provide technical assistance to Firm 5. To comply with the technical assistance provision, the respondent sent an employee who had no prior experience with the divested equipment.

The experience of Firm 5 seems typical. In many other divestitures where the respondent was also required to supply inputs or provide technical assistance, buyers reported having had problems; the supply was late, the quality poor, the technical assistance unhelpful.

(4) Respondents have adverse incentives

The Study did not find conclusive evidence that respondents violated any of the orders in the Study. Nevertheless, it is clear that even where respondents take no actions to deliberately disrupt the buyers' businesses, the respondents have no natural incentive to help the buyers, and that lack of incentive may put the divested business at risk. Where the respondent's assistance is critical, even indifference by the respondent to the buyer's success may make the divested business fail.

In contrast to a Commission-ordered divestiture, the buyer and the seller in a commercial sale of a business either have or can construct incentives that provide both with incentives for a successful transfer of the business. For example, where the owner of a business is licensing technology, it has a natural reason to help the buyer successfully enter the business and maximize its sales. The licensor normally benefits from higher sales of the buyer because the licensor will realize higher royalties. Even where the seller makes an outright sale of its interests, the buyer has many ways in which it can tie its payments to the success of the transfer of the business operations. The buyer can use milestone payments based on the successful transfer of technology or insist on loans from the seller that are secured solely by the acquired assets. Similarly, the seller can protect itself by a license termination provision if the buyer does not live up to its obligations.

Each of these devices creates an on-going and natural community of interest between the buyer and seller. That community of interest may be critical to the success of the transaction because it is often difficult to fully specify in a contract all of the kinds of assistance that may be needed to transfer a business operation, especially if the transfer involves a complex technology or a business operation that is not fully transferred.

- **Firm 14**'s experience illustrates this reliance on natural incentives. Firm 14 stated that, prior to signing the divestiture contract with the respondent, it rarely had entered into written contracts with its suppliers or customers. All its agreements had been oral. It assumed for most of its business relationships that the relationships would work only if the participants had an on-going community of interest.

Divestiture orders and the contracts that implement them, however, are designed to avoid continuing relationships between respondents and the buyers of the divested assets. Establishment of a cooperative relationship between the parties would be inconsistent with the objective of maintaining or restoring competition. Given that respondents will not benefit from the establishment of a successful competitor, respondents have an incentive to minimize the assets that they divest and the assistance that they give to the buyers of those assets.

Accordingly, the Commission's divestiture process must take into account the adverse incentives of the respondent. Unless respondents' incentives can be altered, it is likely that most respondents will do only what is necessary to achieve a consent order and avoid civil penalties. Given the level of support that is necessary for many orders, that minimal effort may not be sufficient to obtain the remedies ordered by the Commission. Fortunately, the Study found that some respondents made special efforts to fully execute their obligations. A later section discusses suggestions based on these successes and other insights that may create incentives for respondents to be more helpful during the transitional process.

b. Buyers

This section begins with an extended discussion of transactions in which the buyers' lack of information led them to make mistakes when they acquired the divested assets. As noted earlier, the case studies indicate that the buyers had access to less accurate information about the to-be-divested assets than staff had supposed, and the buyers' interests in the assets were not as fully aligned with the Commission as staff had supposed. This discussion is long because the tendency of buyers to make mistakes is so counterintuitive that it requires elaboration to understand the fundamental quality of the errors. The extended discussion of buyer's knowledge is also warranted because that lack of knowledge feeds into other problems faced by buyers and by the staff's reliance on buyers. Lack of knowledge explains, in part, the findings of the following two discussions: why buyers bid against their own interests in negotiating disadvantageous deals with respondents; and why buyers do not complain to the Commission or the staff about difficulties that they encountered. The final section discusses transactions that illustrate that buyers may have very different objectives in buying assets than the Commission has when it orders their divestiture.

(1) Buyers lack information

Buyers generally lack important information about the to-be-divested assets. Interviewees (primarily from large corporations) emphasized this fact by stating that one reason they sought to acquire the assets was to learn about the business; entering a new market with the assistance of the knowledgeable employees of an established business represented for them a lower risk strategy than *de novo* entry. Because buyers lacked information, they made mistakes in connection with acquiring on-going businesses, as well as transfers of selected assets and pure technology transfers. Mistakes were made by large diversified corporations that had prior experience in making acquisitions, and by small entrepreneurial companies that had never made an acquisition. Only a small minority of these mistakes were fatal, but many may have lessened the competitive abilities of the buyers. The following examples suggest the range of typical mistakes.

- **Firm 1** was a large, successful, technologically sophisticated, multi divisional manufacturing firm that had been considering entry into a product market related to its own but based on technology with which it was not familiar. The assets that the respondent was required to divest used similar technology to that of the product market Firm 1 sought to enter and therefore fit within the firm's long-range plan. The firm acquired the fully staffed production facility, negotiated the right to hire some higher management personnel, and obtained the right to technological assistance for a period of time. The firm considered its operation of the assets to have been successful. It quickly learned the new technology, introduced new products without seeking any technological assistance, and expanded its market share.

  Firm 1 also learned after the acquisition, however, that it had paid more than what it later determined was a reasonable price for the assets. Firm 1 also discovered it had insisted on signing an uneconomic contract with respondent, under which respondent agreed to buy some by-products produced at the plant. After taking control of the plant, Firm 1 realized that the price it would receive for the by-products was far below the market value. Finally, Firm 1 discovered after the acquisition that respondent had encouraged customers to stockpile products in advance of the sale to Firm 1 so that for a period of time after the acquisition Firm 1 had no customers.

- **Firm 12**, like Firm 1, was a large, successful, technologically sophisticated, multi-divisional firm seeking to enter a new, but related market, by acquiring an on-going operation that used a technology that was unfamiliar to Firm 12. As the order required, it acquired a production facility from respondent, which was dependent on inputs from other firms, and had to share costs of other services with these other firms. It therefore entered into contracts to obtain the inputs and shared services. Firm 12 quickly learned the technology and maintained the market share of that facility, but Firm 12 was more equivocal about claims of overall success.

  After the divestiture, Firm 12 discovered that the supply contracts and shared services contracts it had entered into were so disadvantageous that it could not operate its facility at a profit. Firm 12 stated that it made mistakes in entering into these contracts because it was inexperienced in negotiating shared costs and did not realize the complexities that such arrangements presented. It maintained, nonetheless, that the acquisition may prove to be worthwhile even though this facility will never be profitable, because it is exploiting the technology at other facilities that it owns.

- **Firm 4** was a small but diversified manufacturer that viewed its acquisition of the to-be-divested assets as a good opportunity to enter a new product market with an on-going manufacturing facility. Firm 4 entered into an agreement with respondent to obtain a supply of a necessary part for the product at a price that was profitable to Firm 4. The supply agreement was to last for a specified time period, by the end of which Firm 4 expected to have qualified a replacement supplier that was not also a competitor.

  At the end of the time period, however, Firm 4 had no replacement supplier and was therefore required to negotiate a new supply agreement with respondent, which contained a less favorable price. This higher price made Firm 4's operations unprofitable.

- **Firm 7** was a large, successful, technologically sophisticated, diversified manufacturing company. It acquired a brand name, a product formula and a stockpile of a key ingredient from respondent. Firm 7 believed that the product and the brand name fit well with Firm 7's other products. Rather than acquire only the amount of key ingredient that the Commission required to be divested at a fixed price, Firm 7 instead negotiated with respondent the acquisition of a larger amount at a price to be determined annually.

  After acquiring the assets, Firm 7 discovered that the product contained ingredients banned by one state, a fact that required the cost and delay of reformulation. Even more serious, by not bargaining for a price on the entire amount of the key ingredient, Firm 7 found that respondent had control of its manufacturing costs for the several years that would be required to develop an alternative supply.

- **Firm 8** was a large, successful, diversified company with little manufacturing experience. Because it was one of the likely buyers of the to-be-divested assets, Firm 8 played a role in defining the package of assets to be divested. Firm 8 and other potential buyers asserted that they would be satisfied if respondent were required to divest a key input in the production of the product of concern to the Commission rather than the entire firm respondent was acquiring. Firm 8, which distributed this product, argued that the production process itself was uncomplicated and that it would be better off buying its own production machinery.

  The order required respondent to divest inputs of the buyer's choosing. Firm 8 found that the inputs it selected from respondent's stockpile were defective. In addition, the production machinery it acquired (independent of the order) was inappropriate. As a consequence, it was unable to enter the market of concern to the Commission as quickly as it had intended.

- **Firm 14** was a successful, medium-sized firm that manufactured a single product. It acquired from the respondent technological specifications to manufacture a product related to its single product, machinery to produce the product, and limited rights to acquire amounts of one critical raw material needed to make that product.

  Firm 14 found that the machinery was incompatible with its production process and did not meet federal regulatory standards without certain modifications. Firm 14 was concerned that modifying the machinery would be uneconomic. It also discovered that it could not obtain the critical raw materials it needed for certain products. Respondent would not supply them because the order did not require it to do so. Without the ability to sell these other products, the business could not be profitable. Ultimately, the company abandoned the project entirely.

- **Firm 5,** like Firm 14, was a successful, medium sized, single product manufacturing firm. It acquired from respondent the exclusive right to produce a line of products, rights to acquire production machinery, and technical assistance to operate the machinery. Firm 5 had a choice of production machinery and chose a set that respondent offered at a lower price.

  Firm 5 found that the machinery it chose did not operate as efficiently as the machinery it did not select and that the technical assistance it received was not effective. Firm 5 was, however, able to overcome these problems and manufacture the line of products.

- **Firm 9** was a newly formed corporation headed by an individual with technical expertise in the product and funded by a venture capital company. It acquired from respondent the exclusive right to produce the product and entered into a supply contract with respondent that was to cover the period needed until Firm 9 could develop its own capacity.

Respondent did not deliver the finished product for over a month after the acquisition. Although some compensation was paid, Firm 9 never recovered and went out of business.

- **Firm 16** was a large, successful, technologically sophisticated, diversified manufacturing company. It acquired the rights to a product in development and a supply of the product. The product fit the marketing and sales portfolio of the company well.

  After it acquired the rights, Firm 16 found that it did not have the capability to produce the product. It had made the acquisition without consulting production personnel about the specialized technology needed to produce this product.

In some of these divestitures, the buyers might have avoided the mistakes they made by exercising more "due diligence" before committing themselves to the acquisition.

- **Firm 2**, also a large, sophisticated, diversified manufacturing firm, acquired rights and technology to produce a line of products from respondent. In contrast to the other firms, it consulted its research and manufacturing divisions and tested whether it could use the to-be-divested technology to produce the product. It, thus, determined that it could manufacture the line of products before it agreed to acquire the to-be-divested asset.

Other firms might have protected themselves with better contracts. Firm 12 stated that it has learned how to frame contracts that involve shared facilities as a result of this and another transaction. Firm 9 and Firm 14 had never previously made an acquisition and lacked the experience to anticipate any of problems they might face.

Because the mistakes are so pervasive in the experiences of both successful and unsuccessful buyers, staff is persuaded that mistakes by buyers are inherent in the acquisition process, particularly where buyers have no previous experience in the market. In general, it is not possible to anticipate fully how a firm will operate in advance of the acquisition because the nature of a business is too complex.

(2) Buyers perceive a lack of bargaining power

The case studies indicate that buyers have generally perceived themselves to be in weaker bargaining position than respondents.[27] Although respondents are required to divest within a specified time period at no minimum price, there are often multiple buyers interested in acquiring the assets or lone buyers that believe there are others interested in acquiring the assets. In these circumstances, the price and terms of the sale are dictated by what bidders are offering, not by the theoretical requirement that the assets be sold for no minimum price. Some buyers have represented to the staff that they did not need or want assets or divestiture terms that clearly

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[27] Not all buyers had this perception. Several demanded and received terms that they considered to be advantageous and were not explicitly required by the orders.

would be in their interest. The Study suggests that many of those buyers took those positions because they feared that if they insisted on more favorable terms the respondents would divest the assets to some other bidder.

The buyers of divested assets have been very frank about the mistakes that they have made, and none has even suggested that it knowingly misled the Commission. Nevertheless, it seems likely that buyers knew at the time of negotiations that some contract terms put them at a disadvantage. Presumably, they did not foresee the precise harm; rather, they assumed that they did not need the added protection. They traded away a potential advantage in return for a lower price, or for some other favorable term, or out of fear that some other bidder would be selected. Regardless of the reason, the result has been that some buyers have acquiesced to terms that increased the risks that the Commission's order sought to minimize, while insisting that those terms were not needed.

The insistence on terms that weakened the competitiveness of some buyers was not due to inadvertence; rather the buyers made considered decisions to take risks. It is clear that the buyers considered these issues, because the staff initially opposed specific terms that, in retrospect, could have been foreseen as possibly harmful to the buyers. Staff opposed the terms, not because it had greater knowledge about the businesses, but because of its remedial bias against continuing relationships between competitors. Only because the firms had convinced the staff that they would be good and effective buyers of the to-be-divested assets (a fact that appears to have been true in most cases) was the staff persuaded that the Commission should permit the departures from its institutional bias. The following are cases where divestiture provisions that normally have been opposed by the Commission were accepted at the buyers' urging:

- **Firm 1** and respondent negotiated a divestiture contract that included a provision requiring Firm 1 to sell by-products from the divested plant to the respondent. Staff initially opposed that provision, but Firm 1 argued that taking over the facility was complex, and it needed the assurance for its business plan that the by-products would be sold. Staff ultimately accepted this argument as reasonable, but, in retrospect, it might have been better had staff interpreted this as a sign that Firm 1 had not sufficiently studied the market.

- **Firm 4** negotiated a supply agreement with the respondent that included a limit on the time respondent would supply a necessary component to Firm 4. Staff initially opposed the time limit and argued for a longer supply contract with an option to terminate but Firm 4 argued that it would have an alternative supplier in time. Staff was concerned that the divestiture might fail if Firm 4, contrary to its expectations, was unable to qualify an alternative supplier within the time period. Because staff had no industry specific knowledge, it eventually agreed to support the divestiture contract with the limited supply agreement. Firm 4 suffered competitively when it found it had no replacement supplier at the end of the supply contract.

- **Firm 8** insisted that it could become a more effective competitor if respondent were required to spin off some of its stockpile of key inputs, rather than spin off the fledgling competitor that respondent was acquiring, which was the alternative staff was considering. Firm 8 also insisted that it did not need to have a transfer of manufacturing technology. Firm 8's subsequent problems in selecting from the stockpile of inputs and its difficulty in acquiring appropriate production machinery both reflect problems that would not have existed if the respondent had divested the company it was acquiring.

There is no reason to doubt that all three firms discussed above believed that the overall terms of the divestiture were in their interests. Firm 1 believed it would receive a fair price for the by-products. Firm 4 believed it would have a replacement supplier before the supply agreement with the respondent terminated. Firm 8 believed that it did not need technological assistance to select and operate the production machinery efficiently. In retrospect, though each firm was wrong.

In contrast to Firm 4 and Firm 8, only Firm 1 could have been harmed by resisting the terms suggested by respondent and accepting the position urged by the Commission staff. Had there been no market for the by-products, Firm 1 would have lost revenue absent the contract with respondent. However, the apparent protection that Firm 1 received from the contract mistakenly relied on its ability to bargain effectively with respondent.

The mistakes made by Firms 4 and 8 appear to have been accepting respondents' terms because the terms were clearly contrary to the interests of the buyers. Why should Firm 4 have insisted it did not need more time to find a replacement supplier? Why should Firm 8 have insisted that it did not need to examine the manner in which the respondent operated its productions machinery? It appears that buyers accepted disadvantageous terms, in part, because they overestimated the value of assets they were acquiring. They assumed that the order's requirement of a forced sale of assets at no minimum price gave them a significant chance to buy the business at a bargain price. Thus, it appears that buyers are likely to underrate the harm that adding risks will cause. As noted in the previous section, buyers do not have very good information about the operation or value of the divested assets; consequently, their assumption that they are acquiring a bargain predisposes them to accept contract terms that reduce the value of the divestiture transaction.

The Study suggests that buyers sometimes propose the terms that reduce the value of the transaction because they want to be chosen by the respondent as the buyer. Most buyers told staff that they either knew or assumed that they were not the only business that was interested in acquiring the to-be-divested assets. Consequently, few of the buyers felt that they had any leverage in negotiating with the respondents, and many indicated that their offer would have a greater chance of success if they minimized the contractual burden on the respondent. Accordingly, buyers repeatedly bid against their own interests as a future competitor in hopes that they would be selected as the buyer of the assets in the required divestiture. Their assumption seems to have been that, given a bargain price, they would be able to succeed with even a somewhat diminished asset package.

These assumptions may have undermined orders that were designed to aid the buyers to become strong competitors. Certainly, staff must be careful when evaluating on-going relations between respondents and buyers in proposed divestiture contracts.

(3) Buyers do not often communicate with the Commission regarding difficulties in their dealings with respondents

The Study also revealed that buyers rarely alerted the Commission or Commission staff about their difficulties in dealing with respondents at the time the difficulties occurred. The most significant factor contributing to the firms' reluctance to raise these issues with the Commission was a fear that, if the buyer complained to the Commission, the respondent would provide worse service.[28]

- **Firm 9**, which received no deliveries of finished product in the first month it was in business, did not alert the staff. It received some compensation from the respondent, who later began deliveries. Firm 9 was concerned that its complaints might have soured continuing relations with the respondent and revealed only an accidental production failure that respondent claimed was responsible for the disruption.

- **Firm 14** did not alert staff even though it ultimately discontinued efforts to get into production. In its interview, it stressed that it felt that respondent had acted in bad faith and that it could not do business with a firm without trust. Firm 14 generally operated without written contracts with its suppliers and customers. It accepted that the divestiture contract may have been inadequate to guarantee its rights, because it had never drafted a contract for that purpose. For the same reasons, Firm 14 did not think the Commission could have forced an effective divestiture.

(4) Buyers' interests are different from the FTC's

The Study suggests that interests of buyers may diverge from those of the Commission.

- When **Firm 27** took over part of the operations of the respondent, it continued to operate at the same location. It had a transitional arrangement that allowed it to sell products under the respondent's marketing umbrella while at that location, and it decided to maintain that arrangement after the transitional period. Because the respondent also received some advantage from the arrangement, the arrangement has endured and the result is an implicit partnership, rather than competition, between the firms.

- **Firm 22** acquired a facility from respondent that primarily produced one product that did not compete with respondent but also produced another product that did compete with respondent. Firm 22 put most of its efforts into developing the product that did not compete with respondent. It used respondent's network to sell the product that did compete with respondent. It, thus, guaranteed that it had little effect on the respondent's

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[28] Other buyers in the Study have, however, sought Commission assistance. Firm 4 complained when it had no replacement supplier at the end of the period specified in the divestiture contract. Firm 5 complained that it should have had the right to acquire an associated product to complete its product line. In these two cases, the buyers' complaints were clearly beyond the scope of the applicable order.

business. Although its business was profitable, the divestiture to Firm 22 did not accomplish the remedial purposes of the order.

- **Firm 13** also had a different objective from the Commission's. It acquired the divested assets as part of a multi-year plan to create a business that it would be profitable to resell. It placed few demands on its managers, and thus the assets had little competitive vigor.

- **Firm 7's** acquisition of divested assets should have created a strong competitor. In its interview, Firm 7 described the problems it had encountered in the course of the divestiture, including the realization that it had lost the opportunity to compete on price as a result of failing to stockpile raw materials. Nevertheless, the manager of Firm 7 indicated that the firm's major objective of the transaction had been achieved: Firm 7 now has a complete line so it can compete more effectively on selling its other products. The fact that Firm 7 could not directly challenge respondent for the market in the divested product was of less interest to Firm 7.

The divestiture process should be designed in a way that makes it more likely that the buyer will compete, rather than cooperate, with the respondent after the divestiture is complete. Methods must continue to be developed for reviewing divestitures to distinguish those buyers who are likely to compete from those who are likely either to cooperate or to use the assets for other purposes.

c. Complexities of technology transfers

It is almost always difficult to transfer a business technology unless the individuals who implement the technology also transfer to work for the buyer.

- **Firm 8**, having had no previous manufacturing experience, assumed that with the aid of consultants it could assemble a plant to manufacture the divested product; it thus supported a divestiture of raw material by respondent and opposed what it considered as an inferior option to divest an operating plant that had developed its own source of raw materials. With hindsight, Firm 8's assumption that it could choose the proper raw materials from respondent's stockpile, choose the right production machinery, and properly operate the machinery, was wrong.

- As **Firm 5** discovered, it is difficult to learn how to operate production machinery even if it has been used for that purpose by the respondent and even if someone is reading the instructions from a manual.

The substantial literature about the industrial learning curve[29] suggests that refinements in manufacturing procedures are the source of great productivity gains. The learning curve is applicable to almost every aspect of a business, and the difficulty of transferring knowledge is

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[29] *See, e.g.*, D. Abell and J. Hammond, STRATEGIC MARKET PLANNING 103-133 (1979).

one reason why divestitures of on-going businesses succeeded more often than divestitures of selected assets. Where an entire business is divested with the personnel who operate it, the knowledge will pass as part of the transaction. Finding ways to make successful and effective transfers of trade secrets and technology is a major task in formulating effective remedies.

d. Difficulties in defining viability

The problems that arose in particular divestitures were sometimes the result of an incomplete understanding of the needs of a viable business. The cases discussed below show that even when the Commission properly identified the markets in which the transactions were likely to create competitive harm, the package of assets to be divested may have been drawn too narrowly to create a viable business.

- **Firm 5** was harmed competitively because the order defined the assets-to-be-divested too narrowly. Firm 5 complained at the time it acquired the assets that it needed the right to produce an additional product to be an effective competitor. Respondent refused to include rights to that product because the order did not require it. As Firm 5 feared, some customers refused to allow it to undergo the customers' quality testing program because it was not a full line producer.

- The rights acquired by **Firm 14** to purchase raw materials from respondent were limited to raw materials that Firm 14 would use to manufacture products for customers who were in the market defined in the Commission's complaint. This definition narrowed the potential market for the buyer to the point where Firm 14 decided it was not worthwhile to enter the business.

Establishing a viable competitor requires a thorough understanding of the operations of the business. The order must ensure that the buyer has access to the necessary technology, suppliers, distribution channels and other essential business elements. As noted above, Firm 8's problems in selecting appropriate raw materials from respondent's stockpile and acquiring appropriate manufacturing equipment in the open market illustrate how difficult it can be for a new entrant to understand the range of elements required to operate a business. That kind of difficulty is transmitted to the Commission where, as here, the staff was persuaded by Firm 8 and other potential buyers to recommend that the order require respondent to divest a supply of respondent's own raw materials rather than divest the acquired business which had its own supply of raw materials.

The order in *Promodes*[30] illustrates a related difficulty in framing effective divestitures of less than an entire business. The order was modified to eliminate five of the six required grocery store divestitures when neither the respondent nor the Commission-appointed trustee could locate buyers for the five stores. Their lack of viability may have been related to scale economies in purchasing or advertising. It may be that the stores were subsidized by their chain and were viable only because they established a convenient presence that maintained customer loyalty.

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30 *See Promodes*, note 17, *supra*.

The absence of any buyers for the to-be-divested stores, when they were offered at no minimum price, may also suggest that these stores were never competitively significant.[31] In order to have a basis for recommending the divestiture of individual stores, the staff needs to know details about individual stores and their role in the overall business.

3. Recommendations to increase the effectiveness of divestiture remedies

The following section discusses some ways divestiture remedies can be made more effective, based, in part, on information obtained from the cases studies.

a. Increase respondents' incentives to achieve an effective divestiture

A number of approaches have the potential to increase respondents' incentives to achieve effective divestitures.[32] The case studies, as well as more recent cases, suggest ways to cope with respondents' incentives to advocate ineffective orders, weak buyers, and disadvantageous divestiture contracts.[33]

(1) Appoint auditor trustees

The appointment of an auditor trustee may facilitate the effectiveness of the on-going relationships, some of which are critical to the success of the divestiture. In addition, the reluctance of buyers to alert the staff to difficulties they encountered in dealing with respondents can be mitigated by the appointment of an auditor trustee. The auditor trustee has unrestricted

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[31] Where stores have become unviable because of actions by the respondent, the Commission has obtained civil penalties or additional divestitures, or both. *See, e.g., FTC v. Schnuck Markets, Inc.*, Civ. No. 4:97CV01830CEJ (E.D. Mo. 1997) (consent judgment).

[32] The threat of civil penalties for noncompliance with its obligations under the order may provide some incentive for respondents to comply with the order. The Commission has sought and obtained civil penalties in cases where the respondent has failed to divest in a timely fashion *(see Louisiana Pacific,* note 9, *supra; FTC v. Rite Aid Corp.*, Civ. No. 98CV00484 (D.D.C. 1998)), where respondent has allowed assets to deteriorate before the divestiture is accomplished (see *Schnuck,* note 31, *supra*; *FTC v. Rubus Development Corp. et al.*, Civ. No. 94CV0041 (D.D.C. 1994)), and where the means by which respondent has divested assets has adversely affected the viability of the assets *(FTC v. CVS Corp.*, Civ. No. 98CV00775 (D.D.C. 1998)).

[33] The Commission has begun requiring representations from the respondents that all assets used in the divested business or necessary for its operations are included in the divestiture contract. The greater understanding of the imbalance of knowledge has demonstrated that the staff should not fully rely on buyers to define the elements that should be included in the divestiture package. Respondents generally have the greater knowledge and can reasonably be required to take responsibility for the adequacy of the assets divested. Such representations can be made so that if later it appears that some additional asset should have been included, there is a basis for adding it.

access to the facilities of both the respondent and the buyer and no concerns about informing the Commission. This is particularly true in cases involving supply agreements in which the respondent agrees to supply in-puts or finished product to the buyer and in cases involving the transfer of complex technology.[34] Recently, the Commission has appointed individuals with technical knowledge of the industry to perform those functions that cannot be accomplished by either the parties individually or the Commission. With the combination of their technical knowledge and their unrestricted access, they can resolve disagreements between the respondent and the buyer and determine whether the respondent is performing its obligations, a matter which may be unclear to the buyer.

This independent observer has generally had a beneficial effect by his or her presence. The auditor trustee creates a basis for trust between parties that do not naturally have a community of interest. Also because of their technical backgrounds, the auditors have sometimes found ways to implement the obligations that the parties themselves had not thought of.

The respondent and the buyer know that the auditor has no reason not to inform the Commission if the auditor believes that the obligations are not being fulfilled. The respondent cannot retaliate against the auditor for filing a truthful report with the Commission. The auditor is also well positioned to report to the Commission if the buyer is failing to follow the business plan submitted to the Commission or otherwise is failing to comply with any conditions of the divestiture.

(2) Require divestiture of a crown jewel if respondent fails to divest during the divestiture period

The case studies suggest that the inclusion of a crown jewel provision may have an impact on the incentives of respondents.[35] To avoid divestiture of the crown jewel, the respondent has an incentive to propose initially a package of assets that is adequate to create a viable competitor and for which an acceptable buyer will be found.

There are several grounds for including a crown jewel. The crown jewel gives the Commission the assurance that should no acceptable buyer be found for the to-be-divested assets, there is a larger, more saleable, package for which an acceptable buyer can be found. In addition, by maintaining the possibility that the respondent may have to divest the crown jewel

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[34] The Commission has also used auditor trustees to monitor hold separate agreements, which are designed both to create an entity that actually competes with the respondent before the divestiture occurs and to create a firewall to prevent the respondent from learning about the operations of the held-separate entity. When properly framed, hold separate agreements can reduce both pre- and post- divestiture competitive harm.

[35] An appropriate crown jewel provision requires divestiture of a freestanding business with a customer base. No respondent subject to a crown jewel provision has ever failed to divest within the time required by the order.

and retain instead the original divestiture assets, the provision provides an additional reason for the respondent to maintain the strength and viability of the to-be-divested assets.

A crown jewel is not designed as a punishment for failure to divest,[36] but it is clear that respondents may see its imposition as a threat to the value of their acquisitions and therefore institute procedures to ensure there will be no occasion to activate the larger divestiture. The respondent that divested assets to Firm 30 appears to have been much more rigorous in its adherence to the terms of the hold separate agreement than the respondents that divested to Firm 17 and Firm 28. One reason may have been that respondent that divested to Firm 30 was subject to a crown jewel and the respondents that divested to Firm 28 and Firm 17 were not. The first respondent stated directly that the most difficult part of persuading its board to accept the consent order with the Commission was the crown jewel provision. The board was not satisfied with assurances that the language was standard and had never been invoked, but insisted that management set up procedures to ensure that it would not be invoked against them.

It appears that Firm 30, and probably many others, benefitted from the existence of a crown jewel provision. It created an incentive within the respondent to make the order work in the way intended by the Commission. Rather than the indifference or hostility that is exhibited by some respondents, this respondent had an internal reason to see the divestiture succeed.

(3) Require consequential damages for failure to deliver supplies

Interim supply contracts by respondents may be critical to the survival of new operations. The terms of supply contracts created difficulties for Firms 4, 7, 8, and 12. The failure to deliver timely supplies had a terminal effect on Firm 9. Although Firm 9 recovered some damages for non-delivery, supply contracts generally do not provide for any damages, and contract law normally will not compensate the buyer for loss of profits or goodwill. Normally the lack of such remedies does not pose a problem because the interests of the supplier and its customer are aligned; however, respondents are competitors of the buyer of divested business and therefore the respondent does not automatically have an interest in the success of the buyer. As a result of the vulnerability of the buyer, the Commission staff has required that supply contracts specify that buyers will be entitled to damages equal to the loss of business plus the amount necessary to restore the buyer's business for failure to provide timely supplies. Because respondents then share in the economic risk, they have strong incentives to prevent supply failures.

b. Facilitate the success of the buyer

The Study suggests that buyers may be more successful if staff assures that buyers have access to needed information and carefully analyzes proposed buyers in order to recommend appropriate ones.

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[36] The Commission's cease and desist orders may not be punitive. *American Medical International, Inc., et al.*, FTC Docket No. 9158, 104 F.T.C. 1, 223 (1984) (Decision and Order), *citing United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 326 (1961).

(1) Assure that the buyer has access to accurate information

The case studies illustrate that the inherent complexity of a business prevents buyers from fully understanding a business before taking over its operation and frequently even after taking it over. However, some of the buyers could have obtained much better information through more thorough due diligence. Had Firm 16 consulted with its production personnel, it would have discovered that it could not produce the product. Firm 7 should have known that the product it was buying had been banned by one state and would require reformulation before it could be sold. In contrast, as noted above, Firm 2 actually tested its capacity to manufacture the product during the due diligence period. Firm 23 went even further and required respondent to make significant modifications to restore the to-be-divested business before it would sign a contract to buy the assets. It is important, therefore, that proposed buyers be given adequate time and an opportunity to conduct full due diligence, because the information buyers gain can greatly improve the likelihood that the divestitures will succeed.

Given that many buyers appear to bid against themselves (probably for fear that respondent may select another bidder), it is not sufficient that buyers merely be given an opportunity to conduct due diligence. Buyers may be reluctant to take full advantage of the opportunity. This perceived inequality in bargaining power may be reconciled in appropriate cases by taking one or more of the following steps:

1. Require the buyer, as a condition of Commission approval, to submit an acceptable business plan for the assets. Developing a persuasive business plan requires a proposed buyer to consider the full operation of the divested business. The business plan also provides a framework for the staff to consider whether the proposed buyer has fully considered the operation of the business. For example, the production people in Firm 16 would have had to be consulted to develop cost projections and presumably would have indicated they could not manufacture the product.

2. Require the buyer, as a condition of Commission approval, to have final and executed contracts with third parties who will supply any necessary inputs or provide services that the proposed buyer does not intend to undertake itself. The case studies indicate some tension concerning the circumstances in which this requirement is suitable. On the one hand, where the buyer is inexperienced and needs the capacities of a knowledgeable manufacturer or distributor, the staff needs assurance that the buyer will have access to such capabilities. On the other hand, buyers frequently lack essential knowledge before they buy. That is how Firm 1 ended up in an unfavorable contract under which it was bound to sell by-products for less than market value. That is also how Firm 9 ended up with the same distributor as the respondent. That distributor decided that since it had a monopoly it could make more money from Firm 9's product by price discriminating and selling it only to the smaller group of customers who could use only Firm 9's product.

The staff must scrutinize third party contracts with great care. In both of the above cases, there were signs of potential problems. Giving monopoly power to Firm 9's distributor invited abuse. Permitting sales of a significant portion of output to respondent should be discouraged unless there is clear proof that it is necessary or harmless. Respondents, too, will take advantage of their greater knowledge of the economics of the transaction. Moreover, as previously noted, buyers may be willing to give back to the respondent some of the benefits of the divestiture package because they assume they will still be getting a bargain. The Commission should therefore reject suspect contracts and insist on divestitures that establish a more independent business operation.

3. Assure that the buyer fully understands the requirements of the Order. The case studies and the experience of the Bureau of Competition have shown that some respondents have proposed deals to the buyers that transfer less than is required by the order and that buyers have not all been aware that their divestiture contract provided them with less than they were entitled to. Informing the buyer of the terms of the order is both more difficult and more important when orders require "up front" buyers: more difficult because the order is being drafted at the same time respondent is negotiating with a buyer; more important because the buyer's input can be critical to assuring that all necessary assets are divested.

By insisting that the buyer understand the terms of the order, that the buyer submit an acceptable business plan, and that the buyer execute all necessary third party contracts, the staff can assure that the buyer has an opportunity to become as fully informed as possible. The better informed buyer will, in turn, be able to provide better information to the staff.

(2) Select appropriate buyers

Ultimately, the success of a divestiture depends on transferring the business to an appropriate buyer.[37] The Commission generally allows the respondent the first opportunity to market the assets (although it must do so within a specified period of time). This, however, gives the respondent an opportunity to seek weak buyers. As a consequence, the Commission needs to be able to identify which buyers are likely to succeed and which are not. The decision is always fact specific, but the case studies offer some helpful rules of thumb.

[37] The insight about the critical role of the buyer is not new in the Divestiture Study. It was, for example, one of the major points in Elzinga's 1969 article. *See* note 3, *supra,* at 61-66.

(a) The knowledge and experience of the buyer makes a difference

As noted above, the weakness of some of the buyers appears to have resulted from their lack of knowledge. Some paid too much. Some were dependent for assistance on the respondent. Many made other mistakes. The most successful buyers appear to be the ones that know the most about what they were buying.

Frequently, the most knowledgeable and best buyer was the fringe competitor or an entrant extending geographically. Firm 25, for example, who bought a stand alone production facility, already owned another facility in a different geographic market. It took over the new facility, expanded its capacity, and aggressively captured market share without any transitional problems. Firm 32 did essentially the same in a different, but related industry. It installed new operating policies and almost immediately began increasing market share.

In other cases, suppliers or distributors knew enough to be very good buyers. In one case in the study, the order provided an opportunity for the buyer to learn about the industry before it was required to invest in a plant to use the technology it was licensing. The buyer obtained a license to technology from respondent and then was given a number of years in which to build the plant; in the meantime it was supplied with product by respondent. Over that time, it was able to understand the market and did not have to rely on new technology that it did not fully understand.

(b) The degree of the buyer's commitment to the market may make a difference

The staff has insisted on a demonstration of commitment by would-be buyers.[38] Consider the history of Firm 19, which acquired the right to sell a branded product and entered into a supply contract with respondent for a period of time in which the buyer was to develop its own production. Staff discouraged a proposal that would have allowed the buyer to borrow the money from respondent. Had that loan been allowed, the buyer might have made profits during the period of the supply contract and then walked away from the deal with a net profit when the supply arrangement ended. Instead, staff recommended the divestiture contract only after the owner of Firm 19 personally guaranteed the financing. With such a commitment, the only way the buyer could expect to recoup his investment was to plan to operate the business for a period that was longer than the supply contract. Only when the business became no longer dependent on the respondent, could the buyer either continue to operate it or to sell it. Until then, the business had no value because the buyer was entirely dependent on the respondent. The buyer quickly expanded market share and chose to establish its own production facility.

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[38] The term "commitment" is used in the sense that it is used in game theory: an action taken by a party that makes it difficult for that party to alter its position later. *See, e.g.*, M. Porter, COMPETITIVE STRATEGY 102 - 105 (1980).